



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

119647

ENERGY AND MINERALS
DIVISION

September 30, 1982

B-208038

The Honorable Tom Bevill
Chairman, Subcommittee on
Energy and Water Development
Committee on Appropriations
House of Representatives



119647

Dear Mr. Chairman:

Subject: FERC's Proposed 1983 Budget For the Trans Alaska
Pipeline System Case (GAO/EMD-82-130)

This report is the result of our review and analyses of the Federal Energy Regulatory Commission's (FERC's) participation in the Trans-Alaska Pipeline System (TAPS) rate case and the need for FERC to continue its participation in the hearing process at the \$1.4 million funding level proposed for fiscal year 1983. We are aware that the Appropriations Committee has already taken action to reduce the proposed TAPS funding level. We find the committee's concern over and deliberation of these proposed expenditures to be in harmony with our own concerns.

FERC has been involved in the TAPS case since it was transferred from the Interstate Commerce Commission (ICC) on October 1, 1977, pursuant to the Department of Energy (DOE) Organization Act of 1977 (P.L. 95-91). Expenditures on the TAPS case are expected to be about \$11 million by the end of fiscal year 1982 and FERC has yet to release its first opinion on the issues involved.

In summary, we found that although FERC has a legal responsibility to establish just and reasonable oil pipeline rates, the need for continued FERC staff participation in the case is questionable given the minimal impact on consumer prices for petroleum products that apparently will result from a resolution of the tariff requests. There may be an indirect benefit to the general public, however, since it appears that there is the potential for increased windfall profits tax revenues if tariffs are reduced below current levels.

The concession granted the TAPS owners that Alaskan oil could be priced at world market levels removes any current impact that pipeline tariffs might have on petroleum product prices. The level of the pipeline tariffs allowed the TAPS companies only increases or decreases the wellhead prices of their oil. While the wellhead price is of significance to the State of Alaska in terms of royalty and severance tax collections, it has no effect on the prices paid by oil refiners and thus no effect on end-user prices.

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The public could conceivably benefit by FERC's involvement in the TAPS case through the collection of increased windfall profits taxes if (1) a \$522 million decrease in TAPS construction expenditures proposed by FERC is sustained during cross-examination in the TAPS hearing, (2) staff testimony on other issues provides an adequate basis for FERC to reduce the pipeline companies' rate bases by an additional \$300 million and set lower transportation tariffs, and (3) the lower rates are upheld if contested in the courts. The potential benefit could be lost however, if (1) the staff has to withdraw from the case before the testimony it has developed on several major issues is submitted and subjected to cross-examination and (2) intervenors, such as the State of Alaska, are unable or unwilling to provide sufficient supplemental testimony of their own to fill the void left in the hearing record by FERC staff withdrawal.

We believe that if FERC's continued participation in the case is determined to be beneficial, the need for all of the requested \$1.4 million is questionable. Contractor costs of \$500,000 appear to be high given the current status of the case and the extensive contractor efforts that have already been funded in prior years. The \$900,000 for FERC staff costs also appear high given the amount of work that will have been completed by the end of fiscal year 1982 and the potential for completing FERC's cross-examination by early 1983, which should ensure that their findings are included in the hearing record.

In developing the details of FERC's involvement in the TAPS case given below, we reviewed hearing documents, studies, and budget proposals relating to the TAPS issue. We also conducted interviews with FERC attorneys, administrative law judges, other FERC officials, U.S. Geological Survey officials, Department of Justice attorneys, and attorneys representing the State of Alaska. The review was performed in accordance with GAO's current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

BACKGROUND

The Prudhoe Bay oil reserves in Alaska were discovered in the late 1960's. In early 1969, eight oil pipeline companies--each a wholly-owned subsidiary of a major oil company--formally agreed to construct a pipeline from the Prudhoe Bay oil fields to the ice-free port of Valdez, Alaska. From Valdez, the oil was to be transported to lower-48 refiners and markets by ocean-going tankers.

The eight major oil companies control about 80 percent of Alaska's North Slope oil reserves. Each of the oil companies' pipeline subsidiaries owns a portion of the pipeline's capacity under an individual joint interest but ships its oil under

separate tariffs. The eight oil companies formed the Alyeska Pipeline Service Company to construct and operate the TAPS on behalf of the owners.

The pipeline is almost 800 miles long and measures 48 inches in diameter. Pipeline construction officially began in April 1974 and was completed and tested in April 1977. The original TAPS design provided for a carrying capacity of 600,000 barrels per day (b/d) with eventual expansion to 2 million b/d. In July 1974, shortly after construction started, the nominal capacity of TAPS was increased from the initial 600,000 b/d to 1.2 million b/d. TAPS is currently carrying about 1.7 million b/d.

In late May and June 1977, each of the TAPS pipeline companies filed tariffs with the ICC proposing initial tariff rates for transporting oil through TAPS. Six of the tariffs were to be effective at the end of June and two at the end of July. The difference in effective dates resulted from the companies' interpretation of when TAPS should be considered as "in-service." North Slope oil had entered the pipeline at Prudhoe Bay on June 20, 1977, and deliveries to oil tankers at the Valdez terminal began about July 31, 1977.

After the tariffs were filed, ICC held a 1-day hearing to consider arguments presented by the companies and intervenors concerning the justness and reasonableness of the proposed tariffs. On June 28, 1977, ICC found that it had "reason to believe the proposed rates are not just and reasonable." ICC suspended the tariffs for the seven month statutory period and promulgated maximum interim rate levels that would meet its standard of reasonableness. A comparison of the companies' proposed rates and ICC's interim rates is given below.

Comparison of Rates

<u>Carrier</u>	<u>Proposed Initial Rate \$/bbl</u>	<u>Maximum Interim Rate \$/bbl</u>
Amerada Hess Pipeline	\$6.44	\$4.85
ARCO Pipe Line	6.04	4.91
BP Pipelines	6.35	4.68
Exxon Pipeline	6.27	5.10
Mobil Alaska Pipeline	6.31	4.84
Phillips Alaska Pipeline	6.22	4.83
Sohio Pipe Line	6.16	4.70
Union Alaska Pipeline	6.09	4.89

Source: Federal Energy Regulatory Commission

Subsequent to the ICC order, the pipeline companies filed petitions in the U.S. Court of Appeals opposing the ICC decision. On July 9, 1977, 1/ the court upheld ICC. On November 28, 1977, the Supreme Court granted the pipeline companies' petition to reopen the record 2/ and in a decision dated June 6, 1978, unanimously affirmed the Court of Appeals decision in every material aspect. 3/

FERC INVOLVEMENT
IN THE TAPS CASE

On October 1, 1977, about 3 months after ICC set its interim tariff rates for the TAPS companies, jurisdiction over oil pipelines was transferred from the ICC to FERC pursuant to the DOE Act and Executive Order No. 12009. On the same day, the Secretary of Energy transferred the TAPS proceedings to FERC.

Prior to the jurisdictional transfer of the TAPS case to FERC, the ICC Administrative Law Judge (ALJ) held prehearing conferences on the case. On August 16, 1977, the ALJ issued an order that divided the hearing into two phases and directed that the issues to be determined in Phase I were (1) rate base, (2) rate of return, (3) treatment of taxes, and (4) method of calculating total revenues. Issues reserved for Phase II were (1) questions concerning the allowability of TAPS expenditures as prudent investment, (2) depreciation charges, (3) removal costs, and (4) all other issues not adjudicated in Phase I. After the October 1, 1977, transfer, the TAPS proceeding continued to be governed by ICC's prior orders and its Rules and Regulations pursuant to the savings provisions of Section 705(b) of the DOE Act. In accordance with the provisions, the original issues were not substantively or procedurally affected by the transfer of jurisdiction.

The FERC-designated ALJ began hearings on the Phase I issues on October 13, 1977. Phase I proceedings were completed on July 9, 1979, and the final documents in the case were submitted on July 20, 1979. Based on the record developed up to that point, the ALJ issued his initial decision as to what constitutes just and reasonable rates on February 1, 1980. The interim tariff rates were designed to cover each owner's annual expenses and provide an 11.5 percent return on invested capital using an

1/Mobil Alaska Pipeline Company, et al. v. Interstate Commerce Commission, et al., 557 F. 2d 775 (5th Cir. 1977).

2/434 U.S. 964 (1977).

3/Trans-Alaska Rate Cases, 436 U.S. 631 (1978).

original cost rate base. Recognizing that certain cost of service components (e.g., operating expenses, depreciation and amortization, return, dismantling and restoration, and Federal and state income taxes) remained to be set in Phase II, the following rates were set:

Owner	Filed Rates (\$/bbl)	Just and Reasonable Rates <u>a/</u>	
		1978 (\$/bbl)	1979 (\$/bbl)
Amerada Hess	6.44	5.82	5.07
ARCO	6.04	5.80	5.03
BP	6.35	5.48	4.76
Exxon	6.27	6.13	5.32
Mobil	6.31	5.98	5.20
Phillips	6.22	6.36 <u>b/</u>	5.50
Sohio	6.16	5.29	4.61
Union	6.09	6.20 <u>b/</u>	5.38

a/Two sets of interim rates were ordered by the ALJ to account for the difference in annual pipeline throughput in each year.

b/Owner limited to filed rate.

The rates set for 1978 and 1979 require that any excess tariffs collected in the 2 years be refunded to the shippers. In this case, however, the pipeline owners, for the most part, are also the owners of the oil being shipped. The ALJ also pointed out in his decision that the real effect of reduced tariff rates will be increased royalty payments to Alaska because the market value of the oil at Prudhoe Bay will reflect a larger wellhead price (upon which royalties are based) due to the reduced transportation charges.

Following the initial decision on Phase I in early 1980, the FERC staff began a full-scale investigation of TAPS that was intended to address every allegation and potential issue. This approach included a management prudence examination of the TAPS construction costs with the objective of assessing the reasonableness of the \$9.4 billion spent on the project. This investigation continued until May 1980. At that time it became apparent that with the expected budget cuts, the task was too big and the State of Alaska was doing essentially the same investigation.

A 5-month reevaluation of the scope of FERC's participation was entered into by FERC staff and it was determined that although the four major issues originally reserved for Phase II by the ICC--prudence of TAPS expenditures, depreciation charges, removal costs, and all other issues not adjudicated in Phase I--should be continued, the prudence issue had to be scaled down. Consequently, the staff

determined that the work on prudence of expenditures should be limited to overruns due to (1) the Valdez terminal overburden, (2) the Valdez terminal redesign, (3) "remode" of the pipeline (e.g., above ground v. buried), and (4) planning and scheduling related to these issues.

Work on the four major issues was designated as follows. FERC staff requested that the engineering contractor employed during the earlier part of Phase II, Tippetts-Abbett-McCarthy-Stratton (TAMS), do the work on the cost overruns. The U.S. Army Corps of Engineers was requested to undertake the dismantling, removal and restoration (DR&R) cost issue. The FERC staff itself pursued the depreciation rate issue and also continued its work developing the cost of service issues for Alyeska and two of the eight individual pipeline companies as part of the "...issues not adjudicated in Phase I." FERC staff anticipates that the issues developed for these two pipelines can be applied to the other six.

CURRENT STATUS OF
THE TAPS CASE

According to FERC officials, the TAMS initial testimony on the prudence of expenditure issue was completed and filed with the ALJ on December 16, 1981. TAMS presently has eight people assigned full-time refining their testimony for future hearings and preparing for cross-examination. As of September 1, 1982, the TAMS witnesses were scheduled for the period October 18 through November 24, 1982.

The Corps of Engineers has filed a preliminary report on DR&R costs with FERC's Office of Producer and Pipeline Regulation. The report has also been provided to other parties in the case for possible settlement purposes. No final testimony has been presented to the ALJ. Further Corps of Engineers participation in the hearings will depend primarily on the results of any settlement negotiation on the DR&R issue.

The FERC staff completed the initial work on the depreciation issue and obtained agreement among the parties on the expected life of the pipeline. That agreement has been filed with the ALJ who certified the issue to the Commissioners. The staff is continuing the work of preparing appropriate depreciation schedules based on the expected life of the pipeline. These schedules are not yet completed.

The FERC staff is still developing the cost of service analyses for Alyeska and the two pipeline companies. The staff has informally provided its initial presentation of key issues (top sheets) to all protestants in the case but has not formally filed testimony with the ALJ. The staff expects that the end result of their analyses on cost of service will be a proposed tariff for two of the TAPS

companies that they feel will be just and reasonable. FERC currently has 12 full-time and 10 part-time staff assigned to the TAPS case.

Cross-examination of the State of Alaska prudency witnesses started in February 1982 and is expected to continue until mid-September 1982. As indicated earlier, cross-examination of FERC prudency witnesses is expected to start in October 1982. FERC officials said that although the pipeline companies have been reticent about providing financial data needed to compute a cost of service, they expect the companies to submit data supporting their own proposed tariffs when they become subject to the cross-examination process during hearings sometime in 1983. Since these hearings will introduce new information into the case, FERC officials anticipate that the protestants will request the ALJ to allow a limited discovery period to verify the companies' data. No time estimate was given as to how long such a discovery period could last.

COSTS OF THE TAPS HEARING
THROUGH FISCAL YEAR 1982

By September 30, 1982, FERC will have spent about \$11 million on the TAPS case since it assumed oil pipeline rate jurisdiction on October 1, 1977. An additional \$1.4 million is included for TAPS in FERC's fiscal year 1983 budget request. The following schedule shows the categories and costs of the TAPS case, both actual and budgeted.

FERC Expenditures for TAPS Proceeding (note a)FY 1981 Actual, FY 1982 Budget, and FY 1983 Budget Request

<u>Category</u>	<u>Through FY 1981</u>	<u>Budgeted FY 1982</u>	<u>Budgeted FY 1983</u>
<u>Contracts</u>			
Touche Ross	\$3,952,510	\$ 755,000	-0-
TAMS	1,436,181	883,000	-0-
Litigation/Discovery	315,104	31,000	-0-
Kominers	313,719	-0-	-0-
Goodman	161,978	-0-	-0-
Corps of Engineers	165,000	-0-	-0-
Werner	55,452	-0-	-0-
JURIS	34,735	50,000	-0-
ERA Helicopters	14,236	-0-	-0-
Winfrey	7,500	-0-	-0-
MARC	6,322	-0-	-0-
Subtotal	\$6,462,737	\$ 1,719,000	\$ 500,000
<u>Salaries, Benefits & Overhead</u>			
Legal	\$ 637,769	\$ 222,231	\$ 233,300
Technical	1,130,397	598,129	628,000
Subtotal	\$1,768,166	\$ 820,360	\$ 861,300
<u>Travel</u>			
Legal	\$ 75,497	\$ 5,000	\$ 10,000
Technical	160,760	21,500	40,000
Subtotal	\$ 236,257	\$ 26,500	\$ 50,000
Total	<u>\$8,467,160</u>	<u>\$ 2,565,860</u>	<u>\$1,411,300</u>

a/Does not include expenditures by the Office of Chief Accountant for its ongoing financial audit, by the ALJ, Office of Opinions and Reviews, and members of the Commission.

Source: Federal Energy Regulatory Commission

RATIONALE FOR CONTINUED
FERC INVOLVEMENT IN TAPS

The nature of the TAPS case, (i.e., FERC approval of a requested transportation tariff that will have no effect on the price of petroleum products to consumers), has raised the question of why FERC staff became so involved in the TAPS case and what public benefit is expected to be derived from FERC's continued involvement in the case. FERC staff and others have advanced arguments to refute the contentions that the case is devoid of general public interest and, therefore, that FERC's involvement should have been minimal. Among these arguments are (1) FERC is legally required to set just and reasonable rates for oil pipeline companies and FERC's active participation in the case provides a more complete record for this determination, (2) FERC's staff participation will result in a lower tariff that will enhance competition for further development of Alaska's oil reserves thereby benefitting the whole country, (3) FERC's regulatory staff has experienced a learning process that will enhance its ability to effectively participate in subsequent pipeline rate cases that have a more direct impact on consumer prices, and (4) a number of precedents for future pipeline cases will likely result from the TAPS case and it is important that the staff have the opportunity to provide their input into the case.

The argument can also be raised that reducing the TAPS transportation tariff will increase the windfall profits tax receipts to the U.S. Treasury. The pros and cons of each of these arguments are discussed in the following sections of this report.

FERC authority and need
for staff participation to
provide a complete record

FERC's responsibility to set oil pipeline rates is well established. Sections 15(1) and (7) of the Interstate Commerce Commission Act (49 U.S.C.) (1) authorized ICC to suspend both initial rate tariffs and changes in tariffs and (2) required the ICC to set rates at just and reasonable levels. As we indicated earlier, ICC's jurisdiction over oil pipeline companies was transferred to FERC by the DOE act. FERC also bases its active participation in the TAPS case on the mandate given by the D.C. Circuit Court of Appeals to "build a viable modern (ratemaking) precedent for use in future cases." 1/ Although the mandate was given in the

1/Farmers Union Central Exchange, v. Federal Energy Regulatory Commission, et al., 584 F. 2d 408 (D.C. Cir.) cert. den. 439 U.S. 995 (1978).

court's remand of the ICC's decisions in the Williams Pipe Line Company case, FERC designated the TAPS case, along with the Williams case, as "lead cases" to carry out the mandate. A FERC official also pointed out that in its November 1979 order, FERC stated:

(TAPS) is undoubtedly the most important oil pipeline rate case in history. The sums at stake are enormous. The questions presented are numerous, intricate, novel, fraught with public policy significance. Thus the public interest demands an assiduous inquiry that leaves no stone unturned...the staff must analyze every scrap of paper.

As a consequence, FERC staff not only actively participated in the Phase I hearings of the TAPS case but, as discussed previously, has undertaken the task of preparing major segments of the Phase II hearing process.

Although questions can be raised about the need for FERC staff to have gotten so deeply involved in developing a position on the issues in the TAPS case, the present concern centers around the staff's continued participation and the expenditure of additional taxpayer funds. The State of Alaska appears to have the ability to fund its intervention activities 1/ and develop a case for questioning the prudence of TAPS' construction costs. The State is also developing cost of service analyses for all eight pipeline companies, including rate base items other than construction costs. The staff contends, however, that there are other important issues relating to both cost of construction and cost of service in the case that need developing which it sees as areas of responsibility for FERC and which are not being addressed by the State of Alaska. Furthermore, it sees a need for FERC to serve as a balancing element between the intervenors' objective of reducing tariffs as low as possible and the pipeline companies' objective of keeping the tariff higher--neither of which may be considered as furthering the goal of developing a viable precedent for future pipeline cases or a just and reasonable rate for this case.

State of Alaska representatives told us that they would be required to address some additional important issues if the FERC staff were to withdraw from the case. They were uncertain as to exactly how they would proceed in FERC's absence, but indicated it would be a time-consuming and costly process at this point in the hearing and that some issues would possibly not be covered at

1/Alaska has spent about \$16.6 million on the case through June 30, 1982, and has budgeted \$7.38 million for the period July 1982 through June 1983.

all. They agreed that FERC staff does have certain expert regulatory capabilities that would be hard to duplicate outside the agency and that they do serve a useful role in reaching an equitable resolution of the issues.

A FERC official said that in past natural gas and electric utility rate cases, the FERC staff has normally taken an active role in assessing the adequacy of the utility companies' supporting documentation, with intervenors sometimes playing a lesser role. Along with its primary role of ensuring that FERC have sufficient evidence on which to establish a just and reasonable rate, the staff substituted, as it were, for the average consumer who had neither the time nor money to adequately evaluate and contest the proposed rate increase. With this prior record of active involvement to ensure a complete record of the case, it was not a new approach for the staff to get heavily involved in the TAPS case when it became FERC's responsibility. The FERC official also pointed out, however, that the gas and electric rate cases are not the same as TAPS. In the former cases there is a much broader public interest in that FERC's decisions directly affect consumer costs, whereas in the TAPS case the principal beneficiary will be the State of Alaska and its citizens through increased royalty payments and severance taxes. The average consumer of petroleum products does not appear to be affected one way or the other by the level of transportation tariffs to be decided in the TAPS case.

Lower tariffs are viewed
as enhancing further
development of Alaska
oil reserves

The present tariff rates of over \$6 per barrel are viewed by FERC staff as too high and as a deterrent to further exploration and development of Alaska's oil reserves except by the TAPS' owners. They believe that a lower tariff--even below that proposed in the ALJ's initial decision on Phase I in February 1980--would encourage other non-TAPS oil companies to bid on oil leases offered for sale by Alaska and the Federal Government and develop available oil reserves.

Department of Justice (DOJ) officials expressed similar thinking in a May 27, 1982, motion filed with FERC for an expedited decision in Phase I of the TAPS proceeding. DOJ officials stated that although the present tariffs have been determined to be unjust and unreasonable, they continue to be collected by the pipeline companies. The officials see this situation as having an adverse effect upon further exploration and development of North Slope oil reserves. The officials told us that if tariffs were lower, economic theory would suggest that oil companies which are considering investing in Alaska oil exploration would find the lower tariffs

an incentive to do so. ^{1/} One official also said, however, that to his knowledge, no price-sensitivity studies had been done to support the theory that competition for oil leases in Alaska would be increased if tariffs were lower.

U.S. Geological Survey officials told us they were not convinced that the level of TAPS transportation tariffs was significant. They said that, because other exploration and development costs for that area are so high, the tariff levels would not influence a company's decision to increase its exploration activities. None of the officials was aware of any price-sensitivity studies on developing Alaskan reserves and questioned whether economic theories on the issue would be as applicable to Alaskan oil as they might be to lower 48 reserves.

Two recent oil lease sales have been made from the National Petroleum Reserve in Alaska--one in December 1981 and the second in May 1982. The May 1982 sale provides some indication of the interest in developing Alaskan reserves. Twelve tracts were bid on with one of the major TAPS owners bidding on five tracts. With one exception, the other seven tracts were bid on by a variety of oil company consortiums comprised of seven non-TAPS participants and two companies with part interest in TAPS.

TAPS experience will improve
future oil pipeline regulation

Oil pipeline regulation was new to FERC when it assumed jurisdiction over rates in 1977, and FERC staff has indicated the TAPS case has been a good learning experience for future regulatory activities in this area. While some new regulatory insights into oil pipeline issues were probably gained, senior FERC officials apparently felt the staff was capable of handling the TAPS rate issues when the case was transferred to their jurisdiction. In a February 17, 1982, report to your committee, FERC noted that in meetings between ICC and FERC officials after the October 1, 1977, transfer of responsibility, it was determined that the FERC staff had sufficient expertise to

- address classic utility ratemaking issues in the areas of (1) developing rate base, (2) computing proper income taxes, and (3) developing an overall cost of service;
- conduct both management and financial audits; and
- address the rate of return issue.

^{1/}For TAPS, the weighted average transportation charge of \$6.20 represents about 19 percent of the West Coast price of Alaska North Slope oil.

The use of contractor assistance was determined to be necessary only because of limited staff resources to do the audits and the time and effort required for the staff to familiarize itself with all the considerations relevant to oil pipeline rates of return.

Precedent-setting aspects of
TAPS case requires staff input

There is little question that an oil pipeline rate making methodology substantially different from that used by the ICC will emerge from FERC's decision on both the TAPS and Williams cases. Phase I of TAPS and the Williams case have always been viewed as the "lead cases" in establishing the methodology for setting just and reasonable pipeline rates that would then be applied to Phase II issues in the TAPS case and to pending and future oil pipeline rate cases.

It appears, then, that most of the oil pipeline rate precedents are going to emerge from FERC's decisions on Phase I of TAPS and/or the Williams case--not on the decisions that will set the appropriate tariff rates in Phase II of TAPS. FERC staff contends, however, that a number of precedent-setting decisions will also emerge from Phase II. The prudence of cost issue is the most prominent, but staff sees precedent-setting decisions on unique Phase II cost of service issues such as rate treatment for haul roads, camps, management fees, pre-payments and working capital. One FERC official also indicated that the Phase II work done by FERC and the Corps of Engineers on the DR&R study will be useful in developing a methodology for determining negative salvage value in natural gas rate cases.

It is possible that a FERC decision on the Williams case may be forthcoming soon and a better understanding will be obtained of where the precedents in the case will fall. On July 23, 1982, the U.S. District Court granted a motion requiring FERC to make a decision in the Williams case within 60 days. ^{1/} Once the Williams case is decided, it is possible that a FERC decision on Phase I of TAPS will also be forthcoming. It is still questionable, however, that the Phase II hearing will be expedited because of a decision on Phase I since the prudence of construction cost is the primary issue that still must be decided.

Effect on windfall profits
tax of reduced transportation tariffs

It appears that the most definable benefit to the general public that would result from a lowered TAPS transportation tariff is

1/Farmers Union Central Exchange, Inc., et al, V. Federal Energy
Regulatory Commission, et. al., Civil Action No. 82-2065, (D.C.C.,
August 23, 1982)

increased U.S. Treasury revenues resulting from a greater windfall profits tax on Alaskan oil. A Congressional Research Service staff analysis indicates that if the tariff were reduced by \$1, a net yield of about \$181 million in windfall profits taxes would result. The companies' filed rates, which are currently being collected, average \$6.20 per barrel. The FERC ALJ's initial decision established a proposed rate for 1979 that averages \$5.11. FERC staff believes the rate should be even less because the ALJ's proposed rate did not consider the prudence of construction cost issue which is part of the Phase II proceedings. The State of Alaska is questioning about \$1.6 billion of the reported construction costs and FERC's analysis questions an additional \$522 million in costs. In addition, the FERC staff's case will recommend that \$300 million more be deducted for adjustments to depreciation, DR&R, increased oil shipments, and other items. If these cost analyses are sustained in FERC's final order, the potential exists for reduced tariffs--and an increased windfall profits tax yield.

IMPLICATIONS OF FERC
STAFF WITHDRAWAL FROM THE CASE

The termination of FERC staff participation in the TAPS proceeding would place the burden of carrying the case for reduced tariffs on the State of Alaska as the principal intervenor. All the FERC testimony that has not been subject to cross-examination by the pipeline companies would be stricken from the record. As of September 1, 1982, this represents most of the work done by the staff and FERC contractors. Cross-examination of FERC's first witness is expected to start on October 18, 1982. This cross-examination will include FERC's contractor staff as well as FERC staff.

State of Alaska representatives believe that it would be unfair to the State and to the other parties in the case if FERC's participation were curtailed now. They said the State could petition the ALJ to re-open the case so the State could re-examine the issues FERC staff have addressed but they believe such a petition would not be accepted by the ALJ. If additional discovery is needed, and allowed, after the pipeline companies present their supporting data, the State could proceed with the discovery alone although it would require more time and money than if FERC continues to participate until the case is completed.

NEED FOR \$1.4 MILLION
IN 1983 IS QUESTIONABLE

Given the current status of the case and the amount of FERC staff participation that appears to be required to get its testimony on the record, the need for all of the \$1.4 million budgeted for fiscal year 1983 expenditures appears to be questionable. As we indicated earlier, FERC has made extensive use of contractors to supplement its own staff resources in developing specific rate

case issues. Most of the work preparing testimony on these issues will be completed by the end of fiscal year 1982. The anticipated completion of FERC's cross-examination in early fiscal year 1983 appears to leave relatively little work remaining for FERC to close out its part of the hearing record although the hearing will continue for some time. FERC staff pointed out, however, that after it is cross-examined, the respondent oil pipelines will present their rebuttal testimony and be cross-examined. After this, protestants (including FERC) will have one final round to present answering testimony and be cross-examined. This could overlap into fiscal year 1984. The staff sees each of these stages as equally important to the development of the issues. While some limited FERC staff participation in these hearing phases might be beneficial, we find the \$500,000 for contractor costs to be high and question the need for all of the proposed \$900,000 in FERC staff costs to continue FERC's participation in the case beyond submitting its prepared testimony, undergoing cross-examination, monitoring the progress of the case, and preparing its final briefs.

CONCLUSIONS

The need for continued participation by FERC staff in the TAPS case in fiscal year 1983 is not clear-cut and the effects of terminating staff's participation at this time are uncertain. The direct benefits to the public outside the State of Alaska of reduced tariffs to the pipeline companies are minimal since the transportation costs do not affect the prices charged to consumers of the petroleum products. There may be an indirect benefit to the general public, however, since it appears that there is a potential for increased windfall profits tax revenues if tariffs are reduced and that potential could be enhanced if FERC is allowed to present its testimony supporting reduced TAPS costs. The impact on future exploration and development of additional Alaskan oil is judgmental. However, ratemaking precedents will almost certainly be set, possibly in both Phase I and II decisions. Therefore, FERC's assumed role as a balancing third-party element that provides a complete hearing record on which Phase II decisions will be made could possibly be justified, primarily because it undertook the development of certain relevant issues in lieu of the intervenors developing them.

We believe that if FERC's continued participation in the case is determined to be beneficial, the need for all of the requested \$1.4 million is questionable. Contractor costs of \$500,000 appear to be high given the current status of the case and the extensive contractor efforts that have already been funded in prior years. The \$900,000 for FERC staff costs also appear high given the amount of work that will have been completed by the end of

fiscal year 1982 and the potential for completing FERC's cross-examination by early 1983, which should ensure that their findings are included in the hearing record.

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As requested by your office, we did not obtain formal agency comments on this report. We will withhold further distribution of the report for 3 days as requested, after which we plan to send copies to the Chairman of the Senate Committee on Appropriations and the Chairman of its Subcommittee on Water and Energy Development; the Director, Office of Management and Budget; and the Chairman, Federal Energy Regulatory Commission.

Sincerely yours,


J. Dexter Peach
Director